In the Supreme Court of the United States

OCTOBER TERM 1924

MIDDLETON S. BORLAND, TRUSTEE IN Bankruptcy of Knauth, Nachod & Kuhne, Petitioner
v.
UNITED STATES OF AMERICA
No. 1085

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

STATEMENT

This case comes here on writ of *certiorari* to review the judgment of the Circuit Court of Appeals for the Second Circuit, allowing priority for claims of the United States filed against bankrupt estates.

The claim of the United States arises out of foreign drafts purchased from Knauth, Nachod & Kuhne by the Post Office Department to pay balances due foreign governments on money-order accounts. The total amount of the government's claim is $147,462.32, which represents the total of

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the amounts paid by the Postmaster General for the drafts, together with two items of $18.80 and and $1.40, respectively, paid by the government for protest fees, cable charges, etc., in the case of two drafts which went to protest. Knauth, Nachod & Kuhne were adjudicated bankrupts before the drafts were presented for payment.

It is not questioned that the claim is a debt due the United States, nor that the debtors, Knauth, Nachod & Kuhne, are insolvent. The claim, therefore, clearly falls within the purview of section 3466 of the Revised Statutes. Whether the claim is entitled to priority of payment under section 64(b)5 of the Bankruptcy Act of 1898 is the only question submitted for the decision of this court.

ARGUMENT

I.

The claim of the Government is a preferred claim under section 3466, Revised Statutes, and section 64(b)5 of the Bankruptcy Act

The right of the United States to priority in payment of its claims against insolvent debtors is statutory. Section 3466, Revised Statutes, taken from the Bankruptcy Act of 1797, provides:

> Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is unsufficient to pay all the debts due from the deceased, the debts due to the United States

> shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

Section 64(b) of the Bankruptcy Act of 1898 (30 Stat. 544, 563) provides:

> The debts to have priority, except as herein provided, and to be paid in full out of bankrupt estates, and the order of payment shall be * * * (5) debts owing to any person who by the laws of the States or the United States is entitled to priority.

The Bankruptcy Acts of April 4, 1800, c. 19, 2 Stat. 19, 36; August 19, 1841, c. 9, 5 Stat. 440, 444; and March 2, 1867, c. 176, 14 Stat. 517, 531, expressly recognized the priority of debts due the United States, thus preserving the provision in the Act of 1797 (section 3466, Revised Statutes) relating to priority. The Bankruptcy Act of 1898, act of July 1, 1898, c. 541, 30 Stat. 544, contains no similar provision in which the United States is expressly named. Under the decision of this court, however, in *Lewis, Trustee,* v. *United States,* 92 U. S. 618, 622, that the provision in the Bankruptcy Act of 1867 expressly according priority to claims of the United States was "*in pari materia* with the several acts giving priority of payment to the

United States, and was doubtless put in to recognize and reaffirm the rights which those statutes give and to exclude the possibility of a different conclusion," it makes no difference that the express provision is omitted from section 64(b) of the Bankruptcy Act of 1898, as the express provision in the Bankruptcy Act of 1867 was a mere reaffirmation of a statutory right then existing.

In section 64(b)5 priority in payment of claims is given to any "person" who is entitled to priority under the laws of the States or the United States.

Section 1(a) of the Bankruptcy Act of 1898 (30 Stat. 544) provides:

> The words and phrases used in this act and in the proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows: * * *
>
> (6) "Corporations" shall mean all bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships. * * *
>
> (19) "Persons" shall include corporations, except where otherwise specified: * * *.

The definitions of the words "corporations" and "persons" contained in clauses 6 and 19, being in no way "inconsistent with the context" of section 64(b)5, these words should be construed as defined. Is the United States a "person" within the meaning of section 64(b)5 as defined by section 1(a) of the Bankruptcy Act?

That the United States is a corporation has been held by this court.

United States v. *Perkins*, 163 U. S. 625, 630–631. There the court said:

> In addition to this, however, the United States are not one of the class of corporations intended by law to be exempt from taxation. What the corporations are to which the exemption was intended to apply are indicated by the tax laws of New York and are confined to those of a religious, educational, charitable, or reformatory purpose. We think it was not intended to apply it to a purely political or governmental corporation like the United States.

In considering the power of the federal government to enter into contracts, Marshall, C. J., in *United States* v. *Maurice*, 2 Brock. 109, said:

> The United States is a government, and consequently a body politic and corporate, capable of attaining the objects for which it was created by the means which are necessary for their attainment. This great corporation was ordained and established by the American people, and endowed by them with great powers for important purposes.

Attorney General Bonaparte, in 26 Op. 447, 448, said: "The United States are a quasi corporation, capable of contracting, suing, receiving, and holding all manner of property and taking by devise," citing *Dugan* v. *United States*, 3 Wheat. 181; *United States* v. *Maurice*, 2 Brock. 109. It has

many of the attributes of a corporation, and is a "person" as defined by the Bankruptcy Act itself. As the word "person" includes corporation, and the United States government is a corporation, it follows that a debt owing to the United States is entitled to priority in payment under section 64(b)5 of the Bankruptcy Act, as being a debt owing to a person who, by a law of the United States (section 3466, Revised Statutes), is entitled to priority.

In appellant's argument, comparing the Act of 1898 with prior acts and asserting that because the United States was not expressly named in section 64(b)5 it was not intended that claims of the United States should have priority, he fails to take into consideration the fact that none of the prior acts contain a defining section as does the Act of 1898. This defining section (section 1(a)) rendered unnecessary the inclusion of the United States by name in section 64(b)5. It must be assumed also that the Congress in enacting the Act of 1898 was aware of the interpretation placed thereon by this court to the effect that the express inclusion of the United States in the prior section was a mere affirmation of an existing right and was placed there "to exclude the possibility of a different conclusion." *Lewis, Trustee,* v. *United States, supra.*

While it is true that this court in *Lewis, Trustee,* v. *United States* had under consideration the Bankruptcy Act of 1867, nevertheless, the statement in that decision that the priority clause in the Bank-

ruptcy Act was to be considered *in pari materia* with section 3466 Revised Statutes, was quoted with approval by this court in *Guarantee Company* v. *Title Guaranty Company,* 224 U. S. 152, 157–158, interpreting the Bankruptcy Act of 1898.

In *Guarantee Company* v. *Title Guaranty Company, supra,* this court sustained the preference of the United States under section 3466, Revised Statutes, to which the appellee was subrogated by section 3468, Revised Statutes, and held that section 64(b) of the Bankruptcy Act of 1898 postponed claims of the government, other than those for taxes, in favor of labor claims. That decision did not deny priority for claims of the government asserted in bankruptcy. It merely held that under the Act of 1898 a new order of priority is prescribed, and that under said Act wages due to any operative, clerk, or house servant are entitled to payment prior to the claims of the United States. It had been asserted in that case that the claim of the United States was entitled to priority over all other claims, and that the surety having paid the claim was entitled under section 3468, Revised Statutes, to the priority accorded the United States government. This court, however, held that claims for wages due clerks, servants, etc., were given priority over the claims of the United States, except for taxes. The necessary inference to be drawn from that decision is that while the United States is still entitled to priority over general creditors, under the Bankruptcy Act, read in con-

nection with section 3466, Revised Statutes, yet under the Act of 1898, wages due clerks and servants were expressly given priority over debts due the United States other than taxes. No other conclusion can be possibly drawn from this decision.

Referring to the decision of this court in *Guarantee Company* v. *Title Guaranty Company, supra,* Judge Learned Hand, of the District Court for the Southern District of New York, *In re Tidewater Coal Exchange* (opinion unpublished), said:

> It was there held that the priority of the United States yielded to the priorities established in Section 64 (b), and, though the precise reasoning is not specifically stated, this can be only because a debt due to the United States falls within Section 64 (b) (5), which is the only clause at all apposite, and which reads as follows: "Debts owing to any person who by the laws of the States or the United States is entitled to priority." This language fits precisely, because the United States is a corporation sovereign, and corporations are "persons" under Section 1 (a) (19). Moreover, so far as anyone has found, it is not only a "person" but the only "person * * * entitled to priority" under any law of the United States. If this is not an express mention of the United States in the statute, it is a very clear indication that its priorities are dependent upon the bankruptcy act. I conclude, therefore, not only that this is true, but that Revised Statutes, Section 3466, applies only because it is incorporated by ref-

> erence just as all laws of the States in *pari materia* are incorporated by the same section.

On appeal to the Circuit Court of Appeals, Second Circuit (*In re Tidewater Coal Exchange,* 280 Fed. 648, 650), it was held that the United States is to be regarded as a "person" within the meaning of section 64(b)5 of the Bankruptcy Act. The court said:

> We have no doubt that the United States is to be regarded as a person within the meaning of the clause cited, and can assert its priority as given to it under section 3466 of the Revised Statutes (Comp. St. Sec. 6372), which is reproduced in the margin. The priority secured to the United States is priority over all creditors. The statutory provision referred to is simply declaratory of the common-law rule which entitles a sovereign to priority over other creditors of an insolvent. *United States* v. *National Surety Co.* 254 U. S. 73, 75; 41 Sup. Ct. 29; 65 L. Ed. 143.

The Circuit Court of Appeals, Second Circuit, in that case denied the right of the Director General of Railroads, as a representative of the United States, to vote for a trustee because of the fact that section 56 of the Bankruptcy Act excludes preferred creditors from voting for trustees. Having accorded priority to the claim of the Director General as being a claim on behalf of the United States, it followed that the Director General, as such

preferred creditor, could not vote for a trustee under the provisions of the Bankruptcy Act.

That section 3466 Revised Statutes is to be read in connection with section 64(b)5 of the Bankruptcy Act of 1898 has been decided by the Circuit Court of Appeals for the Seventh Circuit *In re E. J. Hibner Oil Company,* 264 Fed. 667, and by the Circuit Court of Appeals for the Eighth Circuit *In re Western Implement Company,* 171 Fed. 81. The court *In re Hibner Oil Company,* page 668, said:

> If the claim is property of, and constitutes a debt due to the United States, then concededly its priority was properly found.

In the case of *In re Western Implement Company, supra,* the Circuit Court of Appeals for the 8th Circuit had under consideration a debt owing to the State of Minnesota, and made preferred under a statute of that State. In a *per curiam* opinion the court held that the claim of the State was a preferred one under section 64(b)5 of the Bankruptcy Act, stating that " it arrived at the same conclusion as did the District Court, and for the same reasons."

Judge Purdy in the District Court (166 Fed. 576, 582) reached the conclusion that the claim came under 64(b)5 and stated his reasons as follows:

> The word " persons," as defined by clause 19 of section 1 of the bankruptcy act, is as follows: "(19) Persons shall include cor-

porations"; and, again, the word "corporation" is defined by clause 6 of said section 1 of the bankruptcy law as follows: "Corporations shall mean all bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships, etc."

It can not be doubted that a state is a "body" having some of the powers and privileges of private corporations not possessed by individuals or partnerships; as, for example, the power or privilege of perpetual succession. If, therefore, the word "persons," as employed in clause 5, includes "corporations," and the word "corporations," as used in the bankruptcy law, means "all bodies having any of the powers and privileges" of private corporations not possessed by individuals or partnerships, then it would seem to follow as a necessary and inevitable conclusion that a "state" is a "person" within the meaning of the 5th clause of subdivision "b" of the 64th section of the bankruptcy act.

Further on in the same opinion (pp. 583–584) the Court, after quoting Sec. 3466, U. S. R. S., said:

This statute was enacted on March 3, 1797, c. 20, 1 Stat. 515, and has remained in force until the present day. It expresses the general policy of this government with respect to the preference of debts due to the United States over debts due to its citizens. The various states of the Union have by legislative enactment declared the same public pol-

> icy with respect to preferences of debts due the state, and this public policy of the various states has been recognized by Congress in at least one bankruptcy law, that of 1867. It is difficult to conceive that the Congress, when they enacted the national bankruptcy act of 1898, intended to render nugatory this policy of the federal and state government which had been so distinctly recognized for so many years, and that, too, by a mere failure to insert some express provision covering the subject. In my judgment, clause 5 of subdivision "b" of section 64 was intended by Congress to fully preserve not only the rights of the several states, but the rights of the United States, with respect to priorities of debts due from bankrupt estates.

And still further on, at page 584:

> The bankruptcy act of 1898 contains no express provisions preserving in so many words the priority of debts due the United States, and if priority is to be accorded to such debts the authority therefor must be found in clause 5, subd. "b," § 64, of the bankruptcy act of 1898. I feel satisfied that the United States must be regarded as a "person" within the meaning of that clause (*In re Stoever* (D. C.), 127 Fed. 394); and by a parity of reasoning I am forced to the conclusion that a state should likewise be regarded as a "person" within the meaning of this law.

In *United States* v. *Wood,* 290 Fed. 109, 114, the Circuit Court of Appeals, Second Circuit, cites

with approval Judge Learned Hand's opinion in the Tidewater Coal Exchange case, and reaffirms its own ruling in the same case that the United States is a "person" under the Bankruptcy Act.

The foregoing decisions established beyond doubt that the United States is a "person" as defined by the Bankruptcy Act, and, under the provisions of section 64(b)5 of that Act, read in connection with section 3466 Revised Statutes, is entitled to preference in the payment of its claims filed in bankruptcy proceedings.

II

The omission from the Bankruptcy Act of 1898 of the express provision giving priority to ordinary debts of the United States, contained in the Bankruptcy Act of 1867, has no significance other than changing the order of priorities under the Act.

In *Lewis* v. *United States,* 92 U. S. 618, 622, this court held that the United States was not bound by the Bankruptcy Act of 1867 and that the provision in that statute as to preference was *in pari materia* with the several acts giving priority to the United States. The Court expressed the opinion that the provision as to priority of debts due to the United States in the act of 1867 was put in "to recognize and reaffirm the rights which those statutes (Sec. 3466, etc.) give and to exclude the possibility of a different conclusion." In other words, this provision in the Bankruptcy Act of 1867 was redundant and could be treated as surplusage. This being so it would seem that no sig-

nificance should attach to the fact that this clause was omitted from the act of 1898. When Congress framed the preference section of the Bankruptcy Act of 1898, it clearly intended to make a change in the order of priorities of preferred debts from that in the Act of 1867, and provided in section 64(b)5 that government claims, other than those for taxes, should be paid by the trustee after labor claims. From the wording of the preference section in the Act of 1898, one is led to believe that, in adapting the preference section of the Act of 1867 to the new Act, the framers decided to cut out redundancy and surplusage and embrace debts made preferable by statutes in an omnibus clause, 64(b)5.

In *Guarantee Company* v. *Title Guaranty Company, supra,* this Court referred to the ruling made in *Lewis* v. *United States, supra* and compared the preference provisions in the Bankruptcy Acts of 1867 and 1898 with section 3466, R. S. It sustained the preference of the United States under 3466 to which the appellee was subrogated by section 3468, R. S., and held that section 64(b) of the bankruptcy act of 1898 postponed claims of the Government, other than those for taxes, in favor of labor claims. It is clear the court considered the claim a preferred one under the Bankruptcy Act and the only question was its relative position in the preferred class. This is shown in two sentences almost at the end of the opinion (p. 160) in which Mr. Justice McKenna, writing for the Court, said:

> The policy which dictated it (giving priority to labor claims) was beneficient and well might induce a *postponement* of the claims, even of the sovereign in favor of those who necessarily depended upon their daily labor. And to give such claims priority could in no case seriously affect the sovereign. [Italics ours.]

In *United States* v. *National Surety Company,* 254 U. S. 73, the question under consideration was whether or not a surety which had paid the amount of its liability on a bond of a bankrupt and thus became entitled under section 3468, R. S., to the government's priority, was entitled to equal priority with the Government under 3466, R. S. Held, that it was not. In that case this court did not question the government's priority under section 3466. The claim was not a tax claim, but the controversy arose in the matter of proving it under the Bankruptcy Act of 1898. Mr. Justice Brandeis, speaking for the court, said, page 76:

> To accord such equality would abridge the priority expressly conferred upon the Government.

In the case of *In re Anderson,* 279 Fed. 525, the Circuit Court of Appeals, 2nd Circuit, speaking of the government's preference in bankruptcy proceedings, says at page 527:

> Debts due to the United States are entitled to priority of payment, U. S. Revised Statutes, Sec. 3466 (Comp. St. Sec. 6372). * * * The order of payment to the

> United States is next after the wages due workmen, clerks, or servants which have been earned within three months before the date of the commencement of the proceedings.

What was said by the Circuit Court of Appeals *In re Anderson, supra,* is a concise statement of the law as held by this court in *Guarantee Company* v. *Title Guaranty Company, supra,* and is sustained by the decision of this Court in *United States* v. *National Surety Company, supra.* The latter case involved claims filed in bankruptcy, both parties claiming priority under the provisions of the bankruptcy act. The referee allowed priority for the claim of the United States and accorded equal priority under section 3468, R. S., to the National Surety Company. As the estate was less than the claim of the United States the ruling of the referee would result in the United States and the surety company prorating their claims. While the decision of this court turned on the question of whether the surety company having paid to the government the amount of its bond was entitled under section 3468 to equal priority with the United States, this court held that the claim of the United States must be first satisfied. However, as it has been held that the United States must submit its claims against a bankrupt estate to the referee in bankruptcy, if the government was not entitled to priority under the Bankruptcy Act, both the United States and the surety company would be general creditors only and would prorate

their claims. It is submitted, therefore, that the decision of this Court in the case of *United States* v. *National Surety Company, supra,* is an affirmance of the government's right to priority over general creditors in the payment of its claims filed in bankruptcy proceedings.

In the case of *In re Stoever,* 127 Fed. 394, the District Court for the Eastern District of Pennsylvania in discussing the priority section of the Bankruptcy Act and section 3466 of the Revised Statutes said, page 398:

> What was said in *Lewis* v. *United States* is, I think, equally true of the act of 1898. Section 64, cl. " b " (5), which gives priority to " debts owing to any person who by the laws of the states or the United States is entitled to priority," is in pari materia with Sections 3466 and 3467 of the Revised Statutes, and adds nothing to the rights given by those sections nor takes anything away.

Petitioner in denying the right of the United States to priority under the Bankruptcy Act relies generally upon the recent decision of the Circuit Court of Appeals for the Fourth Circuit in *Davis* v. *Pringle,* 1 Fed. (2nd) 860, and upon the decision of this court in what is known as the *Sloan Shipyards case,* 258 U. S. 549. Case No. 526, *United States Shipping Board Emergency Fleet Corporation* v. *Wood, Trustee in Bankruptcy of the Easternshore Shipbuilding Company, Bankrupt,* argued and decided along with the *Sloan Shipyards case,* involved

the question whether the Emergency Fleet Corporation, having filed its claim in the bankruptcy court, was entitled to the priorities of the United States under the Bankruptcy Act. This Court, on page 570, held that it was not so entitled. The Court said:

> The claim was presented by the Fleet Corporation in its own name, but was put forward by it as an instrumentality of the Government of the United States. It was denied successively by the referee, the District Court, and the Circuit Court of Appeals on the ground that the Fleet Corporation was a distinct entity, and that, whatever might be the law as to a direct claim of the United States, the Fleet Corporation stood like other creditors and was not to be preferred.

This ruling is consistent with the decision in the *Sloan Shipyards Corporation* and the *Astoria Marine Iron Works cases,* where it was held that the Emergency Fleet Corporation is a separate entity, capable of making contracts and being sued thereon, notwithstanding the fact that it is a federal agency. Having held the Fleet Corporation to be a separate and distinct corporation, and, therefore, suable, the court could not consistently hold that it would be entitled to the priority accorded to the United States under the Bankruptcy Act. The minority dissented from the decision of the majority court that the Fleet Corporation is suable, but concurred in the majority opinion that the Fleet Corporation is not entitled to priority

under the Bankruptcy Act, basing its decision on the ground that the United States itself is not so entitled. The petitioner makes the point that as to the question of priority the dissenting opinion is a concurring one, but the majority court did not consider the question of the priority of the United States under the Bankruptcy Act, and did not decide that question.

In fact it can not be held logically that the United States is without priority under the Bankruptcy Act unless it is also held that section 3466 Revised Statutes has been repealed by the Bankruptcy Act of 1898. Attention is invited to the fact that this Court has heretofore recognized section 3466 to be still in effect, unrepealed and unmodified except that by section 64(b) the priority originally given by section 3466 has been subordinated by the Bankruptcy Act to claims for wages due clerks, servants, etc. *Guarantee Company* v. *Title Guaranty Company*, 224 U. S. 152; *United States* v. *National Surety Company*, 254 U. S. 73; *United States* v. *Oklahoma*, 261 U. S. 253, 262.

As against the decisions heretofore cited stands one case, that of the Circuit Court of Appeals, Fourth Circuit, in *In re Pringle*, 1 Fed. (2nd) 860, on which the petitioner places his main reliance. The court there decided that a claim of the Director General of Railroads, although a debt due the United States of the character given preference under section 3466, is not entitled to preference in payment under the Bankruptcy Act of 1898, for

the reason that the Bankruptcy Act completely covers all priorities and distribution of assets and supplants and annuls all previous inconsistent statutes. The court bases its decision on its interpretation of section 64(b)5 of the Bankruptcy Act that the United States is not a " person " in contemplation of paragraph 5, and therefore is not accorded priority under that Act.

This decision, if sustained, practically nullifies section 3466 by limiting its application to receivership and insolvency proceedings not administered by the Bankruptcy Courts. While the Circuit Court of Appeals in that case cites the decision of this court in *Guarantee Company* v. *Title Guaranty Company, supra,* it is submitted that decision does not in any respect sustain the decision of the Circuit Court of Appeals in the *Davis* v. *Pringle* case.

The statement of the court in *Davis* v. *Pringle,* page 863, that " The United States and the several States of the United States are not persons and are not commonly thought of as persons * * * " is not sustained by any citation of authority. On the other hand, attention is respectfully invited to the decision of this court in *Stanley* v. *Schwalby,* 147 U. S. 508, 517, where the court said:

> Of course, the United States were not bound by the laws of the State, yet the word " person " in the statute would include them as a body politic and corporate.

The decision in the *Pringle case* stands alone, opposed by the decisions of the Circuit Courts of

Appeals for the Second Circuit (*In re Tidewater Coal Exchange,* 280 Fed. 648, affirmed in *Borland, Trustee* v. *United States,* now submitted); for the Seventh Circuit (*In re Hibner Oil Company,* 264 Fed. 667); and for the Eighth Circuit (*In re Western Implement Company,* 166 Fed. 576), and by the decisions of this court in *Guarantee Company* v. *Title Guaranty Company, supra,* and *United States* v. *National Surety Company, supra.*

CONCLUSION

It is submitted, therefore, that section 64(b)5 of the Bankruptcy Act of 1898 is *in pari materia* with section 3466, Revised Statutes; that when read together these statutes entitle the United States to priority for its claims filed in bankruptcy; that this view has heretofore been sustained by this Court in *Guarantee Company* v. *Title Guaranty Company, supra,* and should be reaffirmed in this case.

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MAY, 1925.

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